In the Supreme Court of the United States

OCTOBER TERM, 1942

In the Matter of
THE WESTERN PACIFIC RAILROAD COMPANY,
Debtor.

No. 7

FREDERICK H. ECKER, et al., *Petitioners,*

vs.

THE WESTERN PACIFIC RAILROAD CORPORATION, et al., *Respondents.*

No. 8

CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, *Petitioners,*

vs.

THE WESTERN PACIFIC RAILROAD CORPORATION, et al., *Respondents.*

No. 20

THE WESTERN PACIFIC RAILROAD COMPANY, *Cross-Petitioner,*

vs.

FREDERICK H. ECKER, et al., *Cross-Respondents.*

No. 33

RECONSTRUCTION FINANCE CORPORATION, *Petitioner,*

vs.

THE WESTERN PACIFIC RAILROAD CORPORATION, et al., *Respondents.*

No. 61

IRVING TRUST COMPANY, *Petitioner,*

vs.

CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO, et al., *Respondents.*

BRIEF FOR RESPONDENT, THE WESTERN PACIFIC RAILROAD CORPORATION.

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*(Note): Citations to Section 77 of the Bankruptcy Act are too frequent to enumerate.

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REFERENCE TO OPINIONS BELOW.

Opinion of Circuit Court of Appeals:

124 Fed. (2d) 136 (R. 2663).

Opinion of District Court:

34 Fed. Supp. 493 (R. 1569).

Original Report and Order of Interstate Commerce Commission on October 10, 1938:

230 I. C. C. 61 (R. 194).

Commission's Modifying Report and Order, June 21, 1939:

233 I. C. C. 409 (R. 300).

JURISDICTION OF THIS COURT.

As we raise no question of the jurisdiction of this Court, we accept the statements in the briefs of petitioners of the grounds upon which they invoke such jurisdiction.

STATEMENT OF THE CASE.

The briefs of the petitioners set forth correctly the present capitalization of the Debtor, and the new capitalization under the Commission Plan, and we beg leave to refer, in this brief, to these portions of the petitioners' statements, without repeating them.

In addition we add the following:

Many of the relevant facts are set forth in a "Stipulation of Facts Not in Dispute" (hereinafter cited as "Stip.") signed by all the parties to the hearing in the District Court and filed in that Court (R. 1017-1272).

This respondent, The Western Pacific Railroad Corporation, is an unsecured creditor of the Debtor in the sum of $5,786,791, together with interest to January 1, 1939 (the effective date of the Commission Plan) amounting to $1,980,429.11 (Stip. Par. 8, R. 1026-27). The only other unsecured claim is that of the Western Realty Company for $50,000 principal and $11,666.67 interest (Stip. Par. 8, R. 1027). The Western Realty Company is a subsidiary of this respondent, so that this respondent is the holder of all the unsecured claims against Debtor. These claims represent advances made upon open account to the Debtor (Stip. Par. 8, R. 1026-7).

The Western Pacific Railroad Corporation is likewise the holder of all the preferred and common stock of the Debtor (Stip. Par. 8, R. 1027; Stip. Par. 3, R. 1044). Substantially all the stock of the Debtor held by this respondent represents actual cash contributed to the construction of the Debtor's railroad enterprise. Most of the stock was issued to this respondent in a former reorganization, in exchange for the First Mortgage Bonds of the Debtor's predecessor in the aggregate principal amount of $50,000,000, the proceeds of these bonds having been used in constructing and equipping the railroad. The remaining $800,000 par value of the Debtor's stock was issued and sold to this respondent in 1929 at par for cash (Stip. Par. 37, R. 1044).

The unsecured claim and stock equity of The Western Pacific Corporation are not, therefore, "watered" securities, but represent a large cash investment in the actual construction of the enterprise.

The beneficial ownership of the rights of this respondent as stockholder and as creditor of the Debtor is in the

stockholders of this respondent, several thousands in number, the great majority of whom hold not more than fifty shares each (Stip. Par. 49, R. 1942). By the Plan of Reorganization approved by the District Judge (whose order of approval was reversed by the Circuit Court of Appeals) this respondent was totally excluded from participation in the reorganization, its unsecured claim and its stock equity being completely wiped out.

One additional fact may be mentioned in this preliminary statement. The petition of the Debtor, by which the reorganization proceeding was initiated (R. 4), did not allege that the Debtor was "insolvent". It set forth the other ground for seeking reorganization under Section 77 of the Bankruptcy Act as amended, i.e., that the petitioning railroad corporation was "unable to meet its debts as they mature". Neither the Commission nor the Court found, as a matter of fact, that the Debtor was insolvent.

ARGUMENT.

SUMMARY OF THE ARGUMENT.

In a railroad reorganization proceeding under Section 77 of the Bankruptcy Act, as amended (11 U.S.C., Sec. 205), it is the duty of the District Court,[1] before approving a Plan of Reorganization certified to it by the Interstate Commerce Commission, to form an informed, independent judgment on the fairness of the Plan and its compliance with other requirements of Section 77 and with the law of

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[1]Throughout this brief, we use the terms "District Court", "Court" and "Judge", interchangeably with respect to proceedings under Section 77. Section 77 itself speaks at times of the Court, and at other times of the judge.

the land. In this connection the amount and character of the capitalization of the reorganized company are not matters relating solely to the public interest, and thus committed to the discretion of the Commission, subject only to constitutional limitations, want of evidence or the like, but are inseparably bound up with the rights of the individual creditors and stockholders which it is the independent duty of the Court to protect. This protection, to which this respondent is entitled, both as the sole unsecured creditor and as the sole stockholder of the Debtor, and which is guaranteed both by the Constitution and by Section 77 itself, the District Court failed to give.

The Interstate Commerce Commission failed to make the "findings" or "determinations" or "appraisals" of value or of earning power which, under the decision of this Court in

Consolidated Rock Products Co. v. DuBois, 312 U. S. 510,

are essential to enable the District Court to reach an informed, independent judgment on the fairness and equity of the proposed Plan.

The Plan which the District Court approved deprives this respondent of any participation whatever and wipes out its investment in the properties of the Debtor. Throughout the proceedings in the Courts below this respondent (and indeed every other opponent of the Commission's Plan) has fully recognized the priority principle, as laid down in

Northern Pacific Railroad Co. v. Boyd, 228 U. S. 482;

Case v. L. A. Products Co., 308 U. S. 106,

and similar cases. The Western Pacific Railroad Corporation has never questioned that the holders of secured claims must be given recognition to the extent of their claims before anything may be allowed to this respondent as unsecured creditor or as stockholder. If the value of the assets of the Debtor had been proved and found to be sufficient only for the payment of such prior claims, this respondent's investment would in fact be worthless, and its destruction in the reorganization would be justified. But the record in this case shows that the value of the Debtor's assets exceeds the amount of the secured claims entitled to priority; that in fact it exceeds the total of all debts, secured and unsecured. This respondent is accordingly entitled to participate in the reorganized company, both as unsecured creditor and as stockholder.

In any event, the record before the Interstate Commerce Commission and before the District Court is totally lacking in the findings essential to support the conclusion that this respondent, in either of its capacities, may be excluded from participation in the reorganized company. There was no finding by Commission or Court of the value of the Debtor's assets. There was no finding of the earning capacity of those assets.

The decision of the Commission and of the District Court denying participation to this respondent appears to be based on the theory that capitalization of past earnings may be used as the sole basis of determining the value of a railroad company's property. Both the terms of Section 77 and the constitutional requirement of due process preclude the adoption of this as the sole basis of valuation. Under Section 77(e), a major (though not

exclusive) factor in valuation is "earning power", not past or prospective earnings. Even if it were conceded that a forecast of probable future earnings is the equivalent of "earning power", the facts of this case show that past earnings are not a reliable guide to the future earnings that may reasonably be expected. Not only were the earnings of the years preceding the Commission's determination unduly depressed by physical factors and economic conditions which no longer exist, but the actual earning record of the Debtor during the period following the Commission's report shows that the Commission's view of the future possibilities of the enterprise was unduly pessimistic. An estimate of future performance (assuming, contrary to the fact, that such an estimate was made in this case), related to conditions not yet known and therefore necessarily unreliable, is not, we submit, a sufficient foundation for the confiscation of a large investment in a productive enterprise.

All that this respondent seeks is the right to retain whatever value may inhere in its unsecured claims and its stock equity. It recognizes that, in any reorganization, those claims and that equity must be properly subordinated to the prior rights of all secured claimants. It demands neither income nor the return of principal until after the full satisfaction of the income and principal demands, respectively, of prior classes of creditors.

We maintain that the unsecured claims and the stock equity have a present value which is entitled to the protection of the Courts. Even if there were no value immediately measurable, the prospective value of these interests should not be irrevocably destroyed, as they would be if

the Plan now before this Court should be carried into effect. As Commissioner Miller said in dissenting, in part, from the Report of the Commission (R. 283-84), the Plan should provide for a larger issue of no par value common stock to "give the present stockholders a chance to participate in the future profits of the reorganized company".

SCOPE OF THIS BRIEF.

The appeal to the Circuit Court of Appeals was from an order approving the Plan of Reorganization. The Circuit Court of Appeals reversed that order. Viewed in its narrowest aspect, the single question to be decided by this Court is whether the order approving the Plan should be affirmed or reversed.

In applying for certiorari, however, the petitioners not only attacked the grounds upon which the Circuit Court of Appeals had reversed the order approving the Plan, but also emphasized the desirability—as a guide to the Commission and to the lower Courts in other railroad reorganization proceedings—of an exposition by this Court of the interpretation, operation and effect of Section 77. The Interstate Commerce Commission, on whose behalf a supporting memorandum was filed, also urged that this Court go into the broader field so suggested.

Assuming that the second consideration had some part, at least, in moving this Court to issue the writs, we do not limit this brief to supporting the decree of the Circuit Court of Appeals on the record in the case, but shall go, in addition, into a discussion, on more general lines, of Section 77.

I.

THE FUNCTIONS OF THE DISTRICT COURT AND OF THE INTERSTATE COMMERCE COMMISSION UNDER SECTION 77.

All Parties Entitled to "Informed Independent" Judgment of the Court on Fairness and Equity of Plan.

The District Court, in considering whether a plan proposed by the Commission is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, fails to discriminate unfairly, and conforms to the requirements of the law of the land (Section 77(e)), exercises an independent jurisdiction. The Court does not sit merely to review the findings and conclusions of an administrative body, whose determinations are ordinarily free from attack in the Courts except for want of jurisdiction, excess of statutory authority, departure from fundamental legal and procedural rules, lack of evidence, or conflict with constitutional rights. This is apparent both from the general scheme of Section 77 and from its specific provisions.

Section 77 is a part of the Bankruptcy Act. It was enacted as an exercise of the power of Congress "to establish * * * uniform laws on the subject of bankruptcies throughout the United States" (*Const. U. S.*, Art. I, Sec. 8; *Continental Ill. N. B. & T. Co. v. Chicago, R. I. etc. R. R. Co.*, 294 U. S. 648; see also *In re New York N. H. etc. Co.*, 16 Fed. Supp. 504; *Central Hanover B. & T. Co. v. Williams*, 95 Fed. (2d) 210). In general, proceedings under the Bankruptcy Act are committed to the jurisdiction of the District Courts of the United States. The entire structure of Section 77 providing for the reorganization of railroads, like that of 77B (now recast as Chapter X of the Bankruptcy Act of 1938) dealing with reorganizations of

other corporations, clearly contemplates a judicial proceeding. It is true that under Section 77 provision is made for action by both the Interstate Commerce Commission and the Court. No plan can finally become effective until it has the approval of the Court as well as the Commission. The functions of the Commission and of the Court are, however, separate and distinct. Their jurisdiction is not concurrent or co-ordinate. It is perhaps better described as a combined jurisdiction, the action of both being necessary to accomplish a reorganization. Mr. Justice Frankfurter has spoken of the authority of the two bodies as being "intertwined",[2] and Mr. Justice Reed emphasizes the "co-operative" nature of the jurisdictions.[3]

As indicating that the final, and, in a certain sense, superior, jurisdiction lies with the Court, it is to be noted that the proceeding is initiated by a petition filed with the Court, that upon the Judge's approval of the petition, the Court has exclusive jurisdiction of the Debtor and its property, that the Judge appoints (subject to ratification by the Commission) a trustee or trustees, fixes the amount of the bond for every trustee, controls the actions of the trustees, fixes the time for filing claims, and determines classification of creditors and stockholders. A plan certified by the Commission does not become binding unless and until it is confirmed by the Court. In addition, in proceedings under Section 77 the powers of the Court and the rights and liabilities of creditors and others with respect to the Debtor and its property are the same as if an adjudication of bankruptcy had been made on voluntary petition on the day the Debtor's petition was filed.

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[2] *Palmer v. Massachusetts*, 308 U. S. 79, 87.
[3] *Warren v. Palmer*, 310 U. S. 132, 138.

It appears, then, that not only is the proceeding instituted in, and jurisdiction of the Debtor and its property conferred on, the Court, but the final act which makes a plan binding upon the Debtor and all other parties is the confirmation of the plan by the Judge.

But, entirely apart from the foregoing general observations regarding the nature and scope of the statutory proceeding, it is clear beyond question that on a hearing like the one which took place before the District Court, i.e., one which calls for a determination whether the Judge will or will not approve a plan certified by the Commission, the express terms of Section 77 require the Judge to exercise an independent judgment upon the essential questions of law and fact involved in his approval or rejection of the plan. Subdivision (e) declares that "the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this Section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders * * *". The word "satisfied" has often been interpreted. It means: convinced; of the conviction; reasonably certain; relieved of all doubt or uncertainty (56 *C. J.* 131 and cases cited). The Judge is to be *satisfied* that the plan meets the requirements of compliance with the provisions of subsection (b); that it is fair and equitable; that it affords due recognition to the rights of each class; that it does not discriminate unfairly and that it will conform to the requirements of the law of the land regarding the participation of the various classes.

It is not enough, as in most cases of attacks upon actions of administrative bodies, that the Judge or Court conclude that the administrative body had jurisdiction to proceed and that it exercised its jurisdiction regularly and reached its findings upon sufficient evidence. The judicial mind must be satisfied of the truth of the ultimate facts and the soundness of the conclusions. In this respect the provision of Section 77 is substantially identical with that of Section 77B which provided that "the Judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders and is feasible * * * (3) it has been accepted as required by the provisions of subdivision (e), clause (1), of this section * * *".

Considering Section 77B, the Supreme Court of the United States in its decision in

Case v. Los Angeles Lumber Products Co., 308 U. S. 106,

held (p. 114) that:

> "It is clear from a reading of section 77B(f) that the Congress has required both that the required percentages of each class of security holders approve the plan and that the plan be found to be 'fair and equitable'. The former is not a substitute for the latter. The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection."

and, at a later point (p. 115), the Court continues:

> "The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the

function and the duty imposed by the Congress on the District Courts under Section 77B. That function and duty are no less here than they are in equity receivership reorganizations, where this court said: 'Every important determination by the court in receivership proceedings calls for an informed, independent judgment.' (National Surety Co. v. Coriell, 289 U. S. 426, 436.)"

See, also,

Tennessee Pub. Co. v. American Nat. Bank, 299 U. S. 18, 22.

In its most recent pronouncement on corporate reorganizations the Supreme Court has again emphasized the necessity for the Court

"to exercise the 'informed, independent judgment' * * * which appraisal of the fairness of a plan of reorganization entails".

Consolidated Rock Products Co. v. duBois, 312 U. S. 510.

In that case, the decision of the Circuit Court of Appeals reversing an order of the District Court confirming a plan of reorganization was affirmed principally upon the ground that such an order, if made without the exercise of the required independent judgment upon the basis of adequate data and findings, cannot be sustained.

The "Public Interest".

In an attempt to define the scope of the respective functions of the Commission and the Judge under Section 77, consideration must be given to subdivision (d) of Section 77, which provides that the "Commission shall render a report and order in which it shall approve a plan, which

may be different from any which has been proposed, and will in its opinion meet with the requirements of subsections (b) and (e) of this section, and *will be compatible with the public interest;* or it shall render a report and order in which it shall refuse to approve any plan". (Italics ours) It becomes necessary, therefore, to inquire what is embraced within the scope of the "public interest", thus initially placed within the authority of the Commission.

The contention of the petitioners has been and is that the exclusive, or at least primary, jurisdiction of the Commission covers the total capitalization of the reorganized company and the classification and details of that capitalization, leaving to the independent judgment of the Court only the question of distribution of the authorized securities among the several claimants. The total capitalization and its details are deemed by the petitioners to be embraced within the field of "public interest", the distribution of the securities to be matters of private right on which alone the parties are entitled to the independent judgment of the Court. This view, which had been advanced below by the proponents of the plan, was accepted by the learned District Judge, who said in his opinion:

> "The two issues of (1) amount and character of capitalization and (2) distribution of new securities are closely related. The determination of the amount and character of the capitalization (a legislative function affecting the public interest) is exclusively within the province of the Commission. The only qualification, if any, is that the court shall independently determine whether, in the exercise of its jurisdiction, the Commission has acted fairly, within the bounds of the Constitution, and not arbitrarily. The determination of the

> questions relating to the distribution of the new securities, including legal priorities and allocations, involves private rights and is a judicial function, within the province of the court." (34 Fed. Supp. 504; R. 1596-7)

We submit that the distinction so attempted to be made between matters of public interest and matters of private right is not maintainable. It is conceded, on all hands, that the District Judge must, in the exercise of an informed, independent judgment, determine whether the plan is fair and equitable, whether it affords due recognition to the rights of each class of creditors and stockholders, whether it discriminates unfairly in favor of any class, and whether it will conform to the requirements of the law of the land regarding the participation of the various classes (Section 77, subsection (e)). It is impossible to separate the consideration of the amount and character of the authorized capitalization from the question of the fairness and equity of the distribution of the authorized securities and the conformity of the plan to the requirements of the law of the land. The capitalization is so interwoven with the determination of the issues which the Court must determine independently that the Court's function cannot be performed if it is foreclosed by the Commission's fixing of the capitalization to be permitted.

At the risk of undue repetition, we emphasize again that under subsection (e) (as well as under the law settled before Section 77 was enacted) every party is entitled to the informed, independent judgment of the Court on the questions whether the plan is fair and equitable, whether it descriminates unfairly and whether it is in accord with the law of the land. The phrase "the law of

the land" is the equivalent of "due process of law" in the Fifth and Fourteenth Amendments to the Federal Constitution.[4]

Even if Section 77 contained no reference to the "law of the land", it would, of course, still be open to any party in interest to contend that the plan as promulgated by the Commission would result in a confiscation of the party's property or a taking of it without due process of law. Here, however, we find that Section 77 specifically incorporates the protection of the "law of the land". If, as we contend, the effect of the Commission Plan would be to confiscate the property of the stockholders and unsecured creditors and transfer it to secured creditors, no consideration of public interest could justify such an invasion of constitutional rights. As this Court stated in

Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 602,

in holding that the farm mortgage provisions of the Frazier-Lemke Act of June 28, 1934, were an unconstitutional invasion of the rights of holders of farm mortgages:

> "For the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be made to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public."

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[4] *Den v. Hoboken L. I. Co.*, 18 How. 279; *Davidson v. New Orleans*, 96 U. S. 97; *Twining v. New Jersey*, 211 U. S. 78.

The argument in favor of the controlling power of the Commission over the amount and details of the authorized capitalization is not furthered by the effort to describe the exercise of this power, in the language of the District Judge, as "a legislative function affecting the public interest".[5]

It was argued below that reorganization is a legislative function and that the legislature has delegated to the Commission the legislative power of fixing the limits and character of the capitalization of the reorganized company (which the legislature might have exercised itself), just as it has delegated to the Commission the legislative power of fixing rates for carriers. It is quite true that the power of limiting or fixing rates for public services was originally exercised directly by legislative bodies. But even when so exercised the rates fixed were always subject to judicial inquiry to determine whether constitutional rights had been invaded. In such an inquiry into the validity of a rate structure, whether established directly by the legislature or by an administrative body, the Courts have the power to determine whether the rate is confiscatory.[6] In that connection, in so far as the value of the property used in the public service is an element in passing upon the propriety of the rate structure, the parties affected are entitled to the independent determination of a court.

Granting, for the purpose of argument, that the establishment of the authorized capital of a company to be

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[5]See quotation from opinion of trial judge, supra, pp. 14-15.

[6]*Ohio Valley Water Co. v. Ben Avon Borough*, 253 U. S. 287, 291;
Bluefield W. Wks. Co. v. Public Serv. Com., 262 U. S. 679, 689;
St. Joseph Stockyards Co. v. U. S., 289 U. S. 38.

reorganized is a legislative function, let us suppose that the Congress, instead of enacting Section 77, had passed an Act providing that the Western Pacific Railroad Company shall be reorganized on the basis of capitalization proposed in the plan under consideration, leaving no securities available for the unsecured creditors or stockholders of the present company, and providing further that the unsecured claims and the preferred stock and the common stock of the company should be cancelled. Could it be asserted that the doors of the courts would not be open to the holder of the claims and stock equity so excluded for a hearing upon his complaint that his rights had been destroyed and confiscated, or that he would not be entitled to the fullest inquiry into the basis upon which that confiscation had been attempted and whether it did deprive him of his constitutional rights?

The position of the petitioners, accepted by the trial Judge, assumes that the problems involved in a reorganization plan are divisible into two mutually exclusive classes: (1) the class of "public interest", which includes not only total capitalization, but the character and classification thereof (committed to the Commission); and (2) questions of private right (on which the Court must exercise an independent judgment) and which cover simply the distribution among classes of creditors and stockholders of the securities authorized by the Commission's capitalization. This conception, we respectfully submit, finds no support in the statute (Section 77) or in authority. The statute does not undertake to divide the questions involved in a reorganization into two separate water-tight compartments, one labelled "public interest" and the other

"private right"—one involving purely administrative decisions, the other requiring the exercise of judicial power. Indeed such a differentiation, if it had been attempted, would not be practicable or workable. Under Section 77 the requirement that the plan be "fair and equitable" binds both the Commission and the Court, and the latter must be "satisfied" in the exercise of an "informed, independent judgment" that the requirement has been met. The plan must, in the opinion of the Commission, be "compatible with the public interest". Neither requirement presupposes only one possible plan. Various plans may be "fair and equitable". Various plans may be "compatible with the public interest". Both requirements must be met, if a plan of reorganization is to become effective.

A plan may be "fair and equitable" but not "compatible with the public interest". Such a plan would not be approved or certified by the Commission. On the other hand, a plan might be "compatible with the public interest", but not (in the judicial view) "fair and equitable". (For the sake of brevity, we are here combining the statutory requirements of a plan into the single phrase "fair and equitable". The further standards imposed by subsection (e) prohibit—even if that of fairness and equity does not—the approval of a plan which is confiscatory as to any claim or interest.) If the Commission should certify a plan, deeming that it is compatible with the public interest, and that it is fair and equitable, the Court must still exercise its "informed, independent judgment" on the question of fairness and equity, and this judgment cannot be limited by the Commission's determination of the amount and character of the permissible capitalization. Unless the

Court is satisfied that the plan meets the test of fairness, the Court cannot approve it. In other words, a plan of reorganization to be approved must be (a) compatible with the public interest, in the opinion of the Commission, and (b) fair and equitable in the opinion of the Commission and in the informed, independent judgment of the Court. It may be that no plan can be devised which will meet both these tests. If any plan that is in the opinion of the Commission compatible with the public interest is nevertheless unfair and inequitable, or if any fair or equitable plan is not deemed by the Commission to be compatible with the public interest, the result is simply that no reorganization can be accomplished. In such event the Commission may render a report and order "in which it shall refuse to approve any plan" (Section 77(d)). Or if a plan shall be certified by the Commission to the Court and the Judge does not approve the plan, and does not see fit to refer the proceedings back to the Commission, he may dismiss the proceedings (Section 77(e)).

The statute affords no basis for the contention that the Commission (as guardian of the "public interest") has plenary control over both total capitalization and of the details of that capitalization. Section 77, subsection (d), provides merely that the Commission shall approve a plan that will (in its opinion) be "compatible with the public interest". There is nothing in the section referring to capitalization or details of capitalization (except the provision in subsection (b) that fixed charges shall be adequately covered by probable earnings); nothing about public interest as contrasted with or overriding private rights; nothing to limit the Court's power and duty, before it ap-

proves a plan, to be "satisfied", that it is fair and equitable. The Bankruptcy Act contains many other references to "public interest" or "public policy".[7] Obviously many of these can have no relation to details of capitalization or to capitalization at all. The phrase "public interest" in and of itself is not defined in the statute and certainly is not given a statutory meaning as broad as that attributed to it. As this Court said with reference to the Transportation Act, 1920 (U. S. C. Tit. 49), the criterion of the "public interest" is not "a mere general reference to public welfare without any standard to guide determinations * * *". It "has direct relation to adequacy of transportation service, to its essential conditions of economy and efficiency, and to appropriate provision and best use of transportation facilities * * *" (*New York C. S. Corp. v. U. S.*, 287 U. S. 12, 24, 25). So, with respect to Section 77, the "public interest" to be considered by the Commission must be related to the purpose of the statute, i.e., to provide for the reorganization of railroads.

To avoid misunderstanding it may be said at this point that we are not contending that the capital structure of a reorganized company has no relation to the public interest. Our position is that such structure involves considerations, not only of the public interest, but of the fairness and equity of the plan, and that the duty of the trial Court requires an independent judgment on the capitalization, as well as all other features of the plan, in so far as fairness and equity may be involved.

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[7]Sections 14(d), 77(c)(13), 77(o), 77(p), 178, 212, 216(11), 221(5) and 456.

The Commission itself in its original report and order said (R. 243-4, quoted in opinion of District Judge, R. 1583, 34 Fed. Supp.):

> "It will be observed that so far as the capitalization of a reorganized company is concerned, section 77 contains no limitations other than that the fixed charges of the company shall be adequately covered by the probable earnings available therefor, and that the plan as a whole shall be compatible with the public interest. The public interest is not defined, but it would seem obvious that to be compatible with the public interest the plan must provide a capital structure for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern. This requires that the capitalization shall not exceed a conservative appraisal of the assets to be taken over by the reorganized company, and that proposed charges, whether fixed or contingent shall be within its probable earning power."

We have no criticism of the declaration that, to be compatible with the public interest, the plan must provide a capital structure for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern. We do, however, question the statements in the last sentence of the passage just quoted from the Commission's report. In this sentence the Commission indicates that in framing the plan it was guided by two considerations or bases, neither of which finds any justification or support in Section 77 or in other parts of the Bankruptcy Act. In so far as the value of the assets of the Debtor is to be considered in setting up a new capital structure, the Commission takes the position

that the appraisal of the assets should be a "conservative" one. The statute does not warrant any such limitation. Section 77 does not contemplate a reorganization based upon forced sale or liquidation values. It contemplates the reorganization of a debtor as a going concern.[8]

In determining whether a debtor is insolvent in the bankruptcy sense, the Bankruptcy Act itself provides (Section 1(19)) that the test is whether the aggregate of his property "shall not at a fair valuation be sufficient in amount to pay his debts". The statute, then, in so far as valuation may enter into the capital structure, has reference to a "fair" valuation, not a speculative, a liberal or a "conservative" one (*Duncan v. Landis*, 106 Fed. 839, 859).[9]

The assumed requirement that "proposed charges, whether fixed or contingent, shall be within its probable earning power" also introduces a limitation which is not in accord with the statute. The language of subdivision (d) of Section 77 is that the probable earnings shall be adequate to cover the "fixed charges"; not, as the Commission puts it, charges "whether fixed or contingent".

The Meaning of "Fair and Equitable".

The recent decision of this Court in

Case v. Los Angeles Lumber Products Co., 308 U. S. 106,

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[8]See

In re Gibson Hotels, Inc., 24 Fed. Supp. 859;
In re Nathanson Bros. Co., 64 Fed. 912;
In re Klein, 197 Fed. 241.

[9]In this case we contend, and the Circuit Court of Appeals held, that no appraisal or valuation of the assets of the debtor was made by the Commission. The statement in the report is, however, indicative of an approach which had a bearing on the drastic limitation of capitalization adopted by the Commission.

makes it unnecessary to discuss at any length the requirement that a plan of reorganization shall be "fair and equitable". As stated in the opinion in the *Los Angeles Lumber Products* case (308 U. S. 115), the words "fair and equitable", as applied to reorganization proceedings, are words of art which, prior to the enactment of Section 77B, "had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations". Prior decisions, including the well known case of

Northern Pacific Railroad Co. v. Boyd, 228 U. S. 482,

are cited. The effect of the decisions culminating in the pronouncement in the *Los Angeles Lumber Products* case is that no plan is fair and equitable which does not recognize and protect the rights of creditors according to their respective priorities in the assets of the corporation. In this recent decision, the Court refers to

Louisville Trust Co. v. Louisville N. A. & C. R. Co., 174 U. S. 674,

as one in which the Supreme Court reaffirmed the "former rule" that "the stockholders' interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors".

In the *Los Angeles Lumber Products* case the corporation was insolvent, both in the equity and the bankruptcy sense. Under these circumstances the Court held that a plan which permitted stockholders to participate in the reorganization was not "fair and equitable" to the bondholders who obviously could not be paid more than a fraction of their claims. But in a case where (and we contend this is such a case) the corporation is not found to be insolvent in the bankruptcy sense, there is no justification,

in fairness and equity, for excluding the unsecured claims from participation. Furthermore, where the value of the assets exceeds the amount of all claims, secured and unsecured,—as the respondents claim to be the fact here—there is no justification for denying participation to the holders of the stock. It is conceded by us that the creditors have the first right to resort to the assets of the corporation in the order of their priorities to the extent of those assets, but they are not entitled to take all the assets if their value exceeds the amount of the claims. If it is "fair and equitable" that the prior right of creditors to resort to the assets shall be recognized, it is equally "fair and equitable" that when full recognition has been given to the claims of creditors, any surplus of value shall be made available for the stockholders. This is a necessary corollary of the rule laid down in the *Boyd* case and the other decisions referred to in the *Los Angeles Lumber Products* case.[10] The principle that junior claimants are entitled to participation after full recognition has been given to prior claims is declared in

Kansas City T. & R. Co. v. Central U. T. Co., 271 U. S. 445, 455

(an equity foreclosure case) where the Court said:

> "Unsecured creditors of insolvent corporations are entitled to the benefit of the values which remain after lienholders are satisfied, whether this is present or prospective, for dividends or only for purposes of control."

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[10] See
In re Dutch Woodcraft Shops, 14 Fed. Supp. 467;
In re National Food Products Corp., 23 Fed. Supp. 979;
In re Utilities P. & L. Corp., 29 Fed. Supp. 763.

II.

THE COURT BELOW CORRECTLY HELD THAT THE DISTRICT COURT COULD NOT AND DID NOT EXERCISE AN "INFORMED, INDEPENDENT JUDGMENT" ON THE FAIRNESS AND EQUITY OF THE PLAN FOR THE REASON THAT IT DID NOT HAVE BEFORE IT THE NECESSARY FINDINGS OR APPRAISALS OR DETERMINATIONS OF VALUE WHICH ARE ESSENTIAL TO PASSING UPON THE EQUITY AND FAIRNESS OF A PROPOSED PLAN.

Findings of Value of Debtor's Property and of Its Earning Capacity Are Essential.

The decision here under review was rendered by the Circuit Court of Appeals for the Ninth Circuit on November 28, 1941. Two weeks later the Circuit Court of Appeals for the Seventh Circuit rendered its decision in a similar proceeding for the reorganization of another railroad company (*In re Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 124 Fed. (2d) 754). In each of these cases the order of the District Court approving a plan of reorganization certified to it by the Commission was reversed. The respective Courts of Appeals based their decisions primarily, if not exclusively, upon the law declared by this Court in the *Consolidated Rock Products* case, supra, decided March 3, 1941, after the respective District Courts had passed on the plans of reorganization for the Western Pacific and the Chicago, Milwaukee.

Deeming the holdings in the *Consolidated Rock Products* case to be controlling here, and to require the reversal of the District Court's order approving the plan, we ask leave to recall to this Court a few of its own expressions bearing on the point of the necessity of findings of value:

> "On this record no determination of the fairness of any plan of reorganization could be made. Absent

the requisite valuation data, the court was in no position to exercise the 'informed, independent judgment' (National Surety Co. v. Coriell, 289 U. S. 426, 436) which appraisal of the fairness of a plan of reorganization entails. Case v. Los Angeles Lumber Products Co. 308 U. S. 106. And see First Nat. Bank v. Flershem, 290 U. S. 504, 525." (p. 520)

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"We have already noted that no adequate finding was made as to the value of the assets of Consolidated. In view of what we have said, it is apparent that a determination of that value must be made so that criteria will be available to determine an appropriate allocation of new securities between bondholders and stockholders in case there is an equity remaining after the bondholders have been made whole." (p. 524)

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"In the second place, there is the question of the method of valuation. From this record it is apparent that little, if any, effort was made to value the whole enterprise by a capitalization of prospective earnings. The necessity for such an inquiry is emphasized by the poor earnings record of this enterprise in the past. Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization." (p. 525)

The *Consolidated Rock Products* case involved a proceeding under Section 77B. The "findings" or "determinations" which this Court declared to be necessary were findings or determinations of the District Court or Judge. Under Section 77B no administrative body was interposed between the formulation of a plan of reorganization and the Court's action on that plan. But in a railroad reorgani-

zation under Section 77, any finding or determination of value that is necessary is to be made by the Commission and certified to the Court.[11] We must, then, look to the report of the Commission to ascertain whether the requisite findings were made. The District Judge was not called upon to make independent findings of value and did not in fact undertake to do so.[12]

When we contend that the record shows no findings by the Commission of the elements essential to enable the Court to reach a judgment on the fairness of the plan, we are not speaking of "findings" expressed in any technical or formal arrangement of words. Our position is, simply, that to comply with the statute, the Commission must, in its report, disclose that it has made a "determination" or "appraisal" or "finding" of the value of the debtor's assets. We are not, for the present purpose, concerned with the form of words in which the determination of value must be expressed, although it will be noted that this Court, in the *Consolidated Rock Products* case, uses the word "finding". Whatever the mode of expression, there must be something in the report to show what, in the judgment of the Commission, the value of the property was. Lacking this, the District Court did not have the foundation upon which it could exercise an "informed, independent judgment" on the fairness and equity of the plan. Nothing short of this was a compliance with the requirement of subsection (d) of Section 77 that in its report

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[11]Last paragraph of subsection (e): "If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan."

[12]34 Fed. Supp. 493.

"the Commission shall state fully the reasons for its conclusions".

Even though there be no express statutory requirement of findings, it is essential to the validity of orders of administrative officers or bodies that they be supported by adequate findings of basic facts.[13] It cannot be open to question, since the decision of the *Consolidated Rock Products* case, that the determination of the value of the Debtor's property is "basic" on a review of a plan of reorganization which extinguishes junior interests against the claim of their owners that the assets are sufficient in value to allow participation by such owners.

It is true, as urged by the petitioners, that the Commission had before it a mass of data—investments, valuations under Section 19(a) of the Interstate Commerce Act, past earnings, financial history, physical condition, and other elements—upon which a finding or determination might have been made. But to appraise the value from these factors is a process requiring the exercise of judgment and discretion resulting in a final figure of value.[14] The record fails to show that the Commission made any one of the varying determinations of value which might have

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[13] *Panama Ref. Co. v. Ryan*, 293 U. S. 388; *U. S. v. Chicago, Milwaukee etc. R. Co.*, 294 U. S. 499; *Florida v. U. S.*, 282 U. S. 194.

[14] "The ascertainment of the value of a railway system is not a matter of arithmetical calculation and is not governed by any fixed and definite rate. Facts of great variety and number, estimates that are exact and those that are approximations, forecasts based on probabilities and contingencies have bearing and properly may be taken into account to guide judgment in determining what is the money equivalent—the actual value—of the property." (*Rowley v. C. & N. W. R. Co.*, 293 U. S. 102, 109.)

been fairly and reasonably made on the basis of these data.

The Court below (124 Fed. Supp. (2d) 139) listed sixteen items, the values of which (as that Court held) the Commission should have, but did not, determine and certify to the Court. The first of these is the value of "the Debtor's entire property".[15]

This respondent is primarily interested in this item, since only if the total value of the Debtor's assets is less than the sum of the prior and secured claims, can the exclusion of the unsecured creditor and the sole stockholder from participation in the reorganization be sustained as "fair and equitable". By virtue of such exclusion, the other fifteen items affect, more directly, the allocation of new securities among the different classes of secured creditors. Two of these (A. C. James Co. and Railroad Credit Corporation) are also respondents opposing the Plan, and we leave to them the argument of the question whether findings on the items listed (other than the first) are requisite.[15a]

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[15]The want of a finding of "earning capacity" is treated separately, infra, page 41.

[15a]The position of the petitioners on this question is, however, significant in its bearing on the underlying problem of the District Court's power and duty to reach an informed, independent judgment. That position (Inst. Bondholders' Br. pp. 21-22, 111, Br. of Crocker etc. Bank, et al., Trustees, pp. 23-24), is, in effect, that for the purpose of determining the allocations of securities among the classes which are allowed to participate, specific determinations of value of the existing claims of these classes, or of the securities allotted to them, are not necessary, but that it is sufficient if the Commission finds, as it did here, that the securities allotted "represent the equitable equivalent of the debtor's assets available for the satisfaction of claims" (R. 316) and, that "Based upon our conclusion as to relative priority, value and equity of the various claims and the value of the new securities available in ex-

The petitioners virtually concede that the Commission made no finding or determination of the value of the Debtor's property. Their position is (a) that a finding of value, expressed in dollars, is not necessary; and (b) that the authorized capitalization under the Plan imports a determination of value, or at least maximum value.

(The argument based on "findings" that the unsecured claims and the stock equity had no value is treated infra, under head III of this brief.)

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change therefor, we find that the new securities should be allotted as follows: • • •" (R. 317).

What the conclusion of the Commission was as to the "value" of the various claims or the "value" of the new securities available in exchange therefor, does not appear in the report, other than by general discussion of the character and amounts of different securities which the Commission deems warranted.

Whether or not, under the plan, any creditor receives the "equitable equivalent" of the value of his claim is, we submit, a matter on which that creditor is entitled to the "informed, independent judgment" of the Court. How can the Court form such a judgment in the absence of a disclosure by the Commission of the basis upon which it reached the conclusion that the securities allotted did constitute such "equitable equivalent"? What the Commission did was to first fix the amount and classification of allowable capitalization, and then, on finding relative priorities, and finding that there were not enough new securities available to fully compensate claimants secured by refunding bonds (R. 271) to distribute the new securities among the secured claimants. If it were, as petitioners claim, a compliance with Section 77 to allot new securities to each class of claimants, on the basis, not of the value of their claims and the value of the new securities, but of the "equitable equivalent of the debtor's assets • • • in terms of the new securities to be issued" (Br. of Inst. Bondholders, p. 79), it is still true that, in order to furnish to the Court a full statement of "the reasons for its conclusions" (Sec. 77, subsec. (d)) the report must contain enough to enable the Court to ascertain how and why the Commission reached the conclusion that the securities allotted did in fact represent such "equitable equivalent" and whether that conclusion was sound.

In effect, the argument of petitioners subordinates the Court's judicial function of determining independently the "fairness and equity" of the plan to the asserted superior administrative power of the Commission, in the "public interest", to so limit total capitalization as to necessarily cut down or prevent the participation of some classes.

"Dollars and Cents Valuations"

The petitioners for certiorari in No. 7 and No. 8 admit the lack of a finding of value, in the one case directly, in the other inferentially.[16] Both petitions (as well as the briefs of these parties) refer repeatedly to "dollars and cents valuations" or "exact dollar valuations" or like expressions[17] in the effort to show that no such valuations are required.

We know of no way in which the "value" of property (whether it be "market value", or "fair value", or "cash value", or value for purposes of taxation, or rate-making or reorganization) can be measured or expressed otherwise than in terms of money, and that means in terms of dollars. We have already quoted[18] a passage from the opinion of this Court in *Rowley v. C. & N. W. R. Co.*, 293 U. S. 109, in which the opinion treats the "actual value" of railroad property as synonymous with its "money equivalent".

The Authorized Capitalization Is Not a Determination of the Value of Debtor's Property.

The petitioners in their briefs in the lower Court relied upon four District Court cases[19] in support of the proposition that the Commission's findings of permissible capital-

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[16] Petition of Ecker et al., No. 7, p. 19; petition of Crocker Bank et al., No. 8, pp. 2, 4, 6, 7.

[17] Petition of Ecker et al., pp. 22, 24, 25, 28, 29, 30, 31, 33, 34, 37; petition of Crocker Bank et al., pp. 4, 6, 7.

[18] Ante, p. 29, note 14.

[19] *In re Akron, Canton & Youngstown Ry.* (unreported), N. D. 1939;
In re Chicago & Northwestern Ry., 35 Fed. Supp. 230, 245;
In re Chicago, Milwaukee, St. Paul & Pacific R. R. Co., 36 Fed. Supp. 193, 204;
In re Erie R. Co., 37 Fed. Supp. 237.

ization, and findings that various claims and stock interests were without value, were sufficient, and that they were equivalent to a finding that the total capital authorized was equal to (or in excess of) the value of the Debtor's property for purposes of reorganization. All these cases were decided before this Court had rendered its decision in the *Consolidated Rock Products* case. Following that decision the lower Court in the case at bar and the Circuit Court of Appeals for the Seventh Circuit[20] took the contrary view to that which had been declared by the District Courts. It is submitted that the conclusions reached by the two Circuit Courts of Appeals embodied the necessary result of the holding of this Court. Not only did the opinion in the *Consolidated Rock Products* case declare specifically that a finding of the value of the Debtor's property was essential, but that decision, by necessary implication, rejected the idea that the fixing of the authorized total capitalization constitutes a finding of value. The plan before the Court in the *Consolidated Rock Products* case set forth the amount, the character and the details of the capitalization of the reorganized company. If such capitalization had, in itself, been regarded as equivalent to, or comprising, a determination of the value of the Debtor's property, the order of the District Court approving the plan would not have been reversed for want of a finding of such value.

Furthermore, we may point out that the capitalization in this case, unlike any of the others cited, does not fix a total capitalization in any specific or ascertainable

[20] *In re Chicago Milwaukee, St. Paul & Pacific R. R. Co.*, 124 Fed. (2d) 754, reversing the District Court's decision in 36 Fed. Supp. 193.

amount. In each of the cases cited, as well as in the case at bar, the capitalization authorized by the Commission provided for various forms of debt obligations and for preferred stock with a par value, together with no-par common stock. In each of the cases other than the Western Pacific, the report of the Commission treated the no-par common stock at a value of $100 a share, which, when added to the other forms of securities, made up a total capitalization in a specific number of dollars. In the case at bar, the various forms of indebtedness securities and preferred stock of the par value of $100 per share aggregate $65,819,422. No specific value was assigned to the 319,441 shares of no-par common stock.[21] The Plan provides for the distribution of common stock to the first mortgage bondholders and the Reconstruction Finance Corporation at $57 per share, to the Railroad Credit Corporation of like shares of common stock at $62 per share; to the A. C. James Co. of like shares at no specific price (R. 390-92). It is clear that in order to find or fix the amount of total capitalization authorized, it was necessary for the Commission to assign some dollar value to each of the shares of common stock. Since the common stock was assigned to two creditors at $57 a share, to another at $62 and to another at an unstated value, what basis is there for saying that the entire issue of common stock, which embraces the stock assigned to all these creditors, shall be valued at $57 rather than $62 or some other figure?

[21] Unless, as indicated in various passages of the Commission's report (R. 244, 245, 256, 259, 269, 321, 359) the Commission treated the no par stock at $100 per share, in which event the total capitalization would be several million dollars greater than the total of the secured claims recognized under the Plan, together with the unsecured claims.

III.

INSUFFICIENCY OF SO-CALLED "FINDINGS" OF COMMISSION THAT STOCK EQUITY AND UNSECURED CLAIMS HAVE NO VALUE.

As pointed out above, this Court has clearly held in the *Consolidated Rock Products* case that in a reorganization proceeding under Section 77B (and the holding is equally applicable with respect to Section 77) it is impossible to reach an "informed, independent judgment" respecting the fairness and equity of a plan of reorganization in the absence of findings or determinations of the value of property of the Debtor and of the elements of that property entering into the reorganization plan.

This rule was the principal basis upon which the Circuit Court of Appeals for the Ninth Circuit reversed the Order approving the Plan in the Western Pacific case, and upon which the Circuit Court of Appeals for the Seventh Circuit reversed the order of approval in the *Chicago, Milwaukee* case. In each instance the Commission had made a finding that the stock equity was without value. In the Western Pacific case it also made a finding that the unsecured claims were without value.[22] Do these so-called findings (R. 269-270) meet the requirements laid down in the *Consolidated Rock Products* case? It is submitted that they do not, and for several reasons:[23]

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[22]No unsecured claims were involved in the *Chicago, Milwaukee* case.

[23]The findings in question were made under the provisions of subsection (e) of Section 77 which provide that if the Judge shall approve the plan, the plan will then be submitted to the creditors of each class and to the stockholders of each class for acceptance or rejection "provided that submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding (a) that at the time

(a) The finding of the Commission that the stock equity or the unsecured claim has no value is, under the statute, made for a limited purpose only. Its effect is to exclude stockholders or creditors of the respective classes from the right to vote on a submission of a plan for acceptance or rejection. It has no relation to the exercise by the Judge of an "informed, independent judgment" on the fairness of the plan. These findings should not be perverted from their true purpose to that of support for the separate and distinct function of upholding the plan as fair and equitable.

(b) The so-called "findings" express merely conclusions, and not facts. In the absence of determinations of the value of the assets of the Debtor, the District Court is without any basis upon which to form an informed, independent judgment on the question whether there are values sufficient after properly recognizing the priorities of secured claims, to make some provision for unsecured claims, and thereafter for the stock equity, and is hence without a basis for determining independently whether the plan is fair and equitable.

In re 620 Church Street Building Corp., 299 U. S. 24, relied on by petitioners, does not uphold the

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of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value • • • provided further, that submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding • • • that at the time of the finding the interests of such class of creditors have no value". After such submission the results of the vote are to be certified to the Judge who thereupon, if the plan has not been accepted by the requisite majority of each class entitled to vote, may either confirm or refuse to confirm the plan.

sufficiency, of itself alone, of a bare ultimate conclusion of "no value" in junior claims. The findings of the trial Court are set forth in the opinion of this Court. They declare that debtor's property had a fair market value of $245,125 and that the amount of the first mortgage bonds was $445,500. These specific determinations fully justified—indeed required—the conclusions that the claims of junior mortgagees had no value and that there was no equity above the first mortgage. In the instant case there was no finding or determination of the value of the Debtor's property, and no basis therefore upon which the Court could exercise an informed, independent judgment on the presence or absence of value in the unsecured claims or the stock equity.

(c) Subsection (e) authorizes the exclusion from the right to vote if the Commission finds that "at the time of the finding" the stock equity or the interests of a class of creditors has no value. The "finding" therefore relates solely to the time when it is made by the Commission. If, as we endeavor to show later in this brief (p. 54 et seq.), subsequent changes of fact and condition are to be regarded in determining the "fairness and equity" of the plan and the propriety of the Judge's order of approval, such inquiry cannot be foreclosed by the Commission's declaration at an earlier date that the excluded claims and interests had no value.

In the opinion of the Circuit Court of Appeals in the Western Pacific case there was no reference to the question now under discussion. In the Chicago, Milwaukee

case,[24] while the Court, following the decision of this Court in the *Consolidated Rock Products* case, declared with emphasis that "findings must be made on all vital issues, controverted and uncontroverted, and must include values of properties separately considered and also of debtor's property as a whole. Findings must cover values of liens to be surrendered and values of securities given in exchange," its conclusion with reference to the finding that the stock equity was without value was not, we submit, entirely clear. In response to a petition for rehearing the Court, on January 12, 1942, filed a supplemental opinion,[25] in which it declared in effect that the finding that the stock equity had no value was sufficient. It went on to say, however, that the Commission "need not further investigate or make further finding on this issue *unless it is convinced that changed conditions in railroad earnings warrant it.* In other words, the Interstate Commerce Commission has jurisdiction of the matter and may, although it is not required to do so, reexamine the evidence or receive additional evidence. if, in its judgment, justice to the parties requires it." (Italics ours.) Even under this holding, which we venture to question, the so-called findings of no value are not treated as final and conclusive, at least in a case in which, for want of other necessary findings, the order of approval must be reversed. That this is such a case is, we submit, beyond question. Where certain classes of secured creditors do not receive recognition in full, the necessity for findings of value of the property as a whole and of that subject to their liens is clearly essential. As-

[24] 124 Fed. (2d) 754.

[25] Not reported—copy printed as appendix to reply brief of petitioners Frederick H. Ecker et al. for certiorari.

suming, therefore, that the Order of the District Court approving the Plan is to be reversed, and that that Court will then be called on (unless it dismisses the proceeding) to refer the matter back to the Commission, we urge that every practical consideration argues against a ruling that the findings of the Commission that the unsecured claims and the stock equity were without value should be deemed final and conclusive in subsequent proceedings. If, as we believe, the proceeding will again be in the hands of the Commission for further action and consideration, the Commission will undoubtedly reconsider the situation in the light of facts as they may then appear. It will be necessary, in order to frame a new plan and to make proper allocation of new securities as between first mortgage bondholders and creditors secured by pledge of refunding bonds, to determine the value of the property subject to the liens of the respective mortgages. If the sum of the values so found should exceed the total of the secured claims—a result that is more than probable—findings that unsecured claims and stock equity are without value would be in conflict with the specific findings of value of the component parts of the Debtor's property. If the proceedings go back to the Commission for reconsideration there would be no advantage in avoiding a definite finding of the value of the entire assets of the Debtor. Such finding could easily be made and, when made, would afford a proper basis for the final conclusion that the unsecured claims or the stock equity, or both, have, or do not have, value.

Whatever may be the view of this Court on the supposed divergence between the views of the Courts of Appeals for the Seventh and Ninth Circuits, it is submitted

that if a reversal and recommitment be required for want of necessary findings of value in any respect, the Commission should be required to reconsider the entire matter as of the date of its new report and to make findings of value to support, not only its determinations with respect to the secured claims, but also with respect to the unsecured claims and the stock equity. Nothing substantial would be gained by sending the proceeding back to the Commission to make findings of the value of the component parts of the property for the purpose of dealing properly with secured claims, and at the same time requiring the Commission to close its eyes to the effect of such findings on unsecured claims and stock equity. There would be no reason for such action other than that the Commission had once concluded, without the knowledge now available, that at an earlier date the unsecured claims and the stock equity were without value.

IV.

DISCUSSION OF EARNINGS AS MEASURE OF VALUE (WITHOUT REGARD TO SPECIFIC PROVISIONS OF SECTION 77).

In the *Consolidated Rock Products* case, this Court emphasized the controlling importance of the earning capacity of a productive property as the criterion, in reorganization plans, of the value of that property (*312 U. S.* at 312). In the same connection the Court pointed out that "valuations for other purposes are not relevant to, or helpful in, a determination of that issue, except as they may indirectly bear on earning capacity." Assuming, for the moment, that these declarations are as applicable to

a proceeding under Section 77 as to one under 77B, it is, we submit, clear that the Judge's approval of the plan of reorganization in this case cannot stand because of the failure of the Commission to make any finding or determination of the earning capacity of the properties of the Debtor. The report of the Commission contains considerable discussion of past earnings and of the necessity of a realistic relation of the capital structure of the reorganized company to its actual earning power, but nowhere can be found a finding, or determination, or estimate, of what, in terms of money, the prospective earnings are likely to be, or what in the judgment of the Commission the earning capacity of the railroad is. This, as pointed out in the opinion in the *Consolidated Rock Products* case,[26] is essential to a determination of the fairness of a plan of reorganization.

Past Earnings Alone Are Not a Sufficient Basis for Appraising Earning Capacity.

The Commission[27] looked primarily to the past earnings record of the Debtor. The District Judge followed the same line of approach. In his opinion[28] he stated, after tabulating the Debtor's earnings for the years 1922-1939 that "the capitalization permitted by these earnings is a

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[26] "In the second place, there is the question of the method of valuation. From this record it is apparent that little, if any, effort was made to value the whole enterprise by a capitalization of prospective earnings. The necessity for such an inquiry is emphasized by the poor earnings record of this enterprise in the past. Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization." (p. 525.)

[27] R. 244-57.

[28] R. 1592; 34 Fed. Supp. at p. 503.

mere matter of computation". In the accompanying footnote the Court, in endeavoring to show the results of such computation, took averages over a five-year, a ten-year and a seventeen-year period and capitalized them at 5%. These computations are not to be found in the Commission's Report, but, as stated in the footnote, were taken from the brief of the Institutional Bondholders (petitioners here). It is obvious that the results would be different if different periods were taken or if a different rate were used for capitalization. (It must be remembered, however, that the report of the Commission does not disclose that it attempted to capitalize earnings at all, much less at the assumed rate of 5%). In any event, where the inquiry is into the value of property as indicated or determined by its earning *capacity*, the real question is not what the property earned in the past, but what it may fairly be deemed able to earn in the future. The record of past earnings serves no purpose other than to afford a basis upon which one may forecast or estimate what the earnings may be in the future.

> "Value, under any plausible theory of capitalized earning power, is necessarily forward looking • • • The past earnings are therefore beside the point, save as a possible index of future earnings."[29]

More than this, the extent to which past earnings may be indicative of future possibilities depends upon the circumstances and conditions under which the property was operated in the past, which may be very different from those which will govern its performance in the future. In

[29]Bonbright on Valuation, 250.

the *Consolidated Rock Products Company* case[30] the Court says, in speaking of the test of earning capacity:

> "Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance."

In the case at bar the record shows that during the period preceding the Commission's Report the conditions under which the Debtor operated were such that its earnings could not be taken as a satisfactory guide to what it was likely to do thereafter.

It is hardly necessary to point out that the year 1929 inaugurated a period of severe economic and financial depression which reduced the traffic and earnings of railroads as well as the business of other enterprises. Past earnings during a depression period can obviously furnish only a very uncertain guide to even the immediate, to say nothing of the remote, future. Furthermore, the properties of the Debtor had not, in the years preceding 1929, been maintained in proper operating condition. In 1927 an extensive program of rehabilitation was undertaken, upon which approximately $8,000,000 was spent before 1931 (Stip. Par. 50, R. 1052). A similar program was resumed, by the trustees, in the years 1936-1938, and approximately

[30] 312 U. S. at p. 526.

$10,0000,000 additional was so expended during those years (See Exh. "C" to Stip. R. 1214; Stip. Par. 132, R. 1092). As a result of the 1926-1938 rehabilitation program, there is no deferred maintenance in the Debtor's properties and its facilities and equipment are sufficient to handle traffic expeditiously and efficiently (Stip. Par. 73, R. 1063). In giving consideration to past earnings, it is necessary, not only to adjust the figures with reference to the amounts spent for rehabilitation but charged to operations under the Commission's accounting rules (as has been done in the figures presented to the Commission and quoted by the District Court in its opinion), but also to bear in mind the effect on future earnings of the improved condition of the properties and the present ability of the Debtor to handle traffic efficiently.

Another important factor is the construction by the Debtor of its Northern California Extension, connecting the Western Pacific System with that of the Great Northern Railway Company (Stip. Par. 51, R. 1052-53). The additional earning power created by this addition became fully operative only during the latter part of the period preceding the report of the Commission.

V.

OTHER ELEMENTS TO BE CONSIDERED IN VALUATION UNDER SECTION 77.

(a) Elements other than earning capacity.

Up to this point we have assumed that the expressions of this Court, in the *Consolidated Rock Products* case (a 77B case), regarding earning capacity as a criterion of value, are equally applicable to a proceeding under Sec-

tion 77. We venture to suggest, however, that the views so advanced should be qualified when the inquiry arises in a railroad reorganization. One of the amendments of 1935 to Section 77 adds, to subsection (e), a definition of the basis upon which value of property of a railroad corporation shall be determined. The provision reads:

> "The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

Notwithstanding the vagueness of the language—a vagueness which was perhaps intentional[31]—the enactment clearly requires that consideration be given to factors other than earning power. No doubt, "earning power of the property, past, present and prospective" is declared to be an important, and perhaps the most important, element in the inquiry, but it cannot, consistently with the language of the statute, be regarded as the sole or exclusive element.

Clearly, we submit, when the Congress provided that consideration should be given to earning power "and all other relevant facts" it did not regard earning power as the sole relevant fact. When it provided that only such

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[31]See statement of Mr. Leslie Craven, draftsman of the provision, quoted in opinion of District Judge (34 Fed. Supp. 500 (R. 1584)).

effect should be given to cost of reproduction, cost and investment, as required under the law of the land in light of its earning power and all other relevant facts, it again made manifest its purpose that some weight ought or should be given to the enumerated factors other than earning power.

In the present case, neither the Commission nor the District Court made any specific determination or finding of the value of the property. It had, however, made valuations of the property and the investment of the Debtor on a number of earlier occasions, and made one or two quite recently. Some of these prior valuations are referred to in the Commission's Report. These valuations are set forth in the Stip. The subject is fully covered in Paragraphs 57-71, inclusive, of the Stip. (R. 1058-63). We tabulate here the different valuations found or referred to by the Commission for various purposes, arranging them in order of amount for convenient comparison with the total of the secured claims—$87,888,660—and the total of all claims, secured and unsecured—$95,699,502.

Value Found	Nature of Finding	Paragraph of Stip.
$139,600,455	Final valuation of Debtor's properties, plus final valuations of properties of subsidiaries, pursuant to Sec. 19(a) of Interstate Commerce Act, plus net costs of additions and retirements between valuation dates and 12/31/35, as stated in Commission's report of 10/10/38 herein	57, 58 & 59
$140,930,391	Final valuation under Sec. 19(a) of Interstate Commerce Act plus in-	

Value Found	Nature of Finding	Paragraph of Stip.
	vestment made by Debtor between valuation date and 12/31/35	70
$144,619,851	Final valuation of Debtor's properties, plus final valuations of properties of subsidiaries, pursuant to Sec. 19(a) of Interstate Commerce Act, plus capital expenditures between valuation dates and 12/31/35, as stated in Proposed Report of Commission's Bureau of Finance herein, dated 8/2/37	60, 61
$144,978,559	Investment in road and equipment less accrued equipment depreciation as of 12/31/38	71
$147,056,283	Total capital assets as of 12/31/31, as found by Commission in its report dated 2/27/32 authorizing issuance of $15,000,000 of general and refunding mortgage bonds	64
$148,796,047	Total capital assets as of 5/31/32, as found by Commission in its report dated 12/9/32 authorizing issuance of $4,000,000 of general and refunding mortgage bonds	65
$150,907,623	Valuations found by Commission under Sec. 19(a) of Interstate Commerce Act, with additions, betterments, etc., since valuation dates as shown on books of trustees as of 12/31/38	68
$166,960,037	Total investment of Debtor as shown on its balance sheet pre-	

Value Found	Nature of Finding	Paragraph of Stip.
	pared in accordance with Commission's accounting rules as of 12/31/35	69
$171,096,992	Book value as of 11/30/36, as stated in Proposed Report of Commission's Bureau of Finance herein, dated 8/2/37	62
$173,650,980	Assets per balance sheet of Debtor's trustees as of 6/30/38, as stated in Commission's report of 10/10/38 herein	63
$174,936,239	Assets per balance sheet of Debtor and trustees as of 8/31/38, as stated in Commission's report dated 11/10/38 authorizing borrowing of $10,000,000 by trustees	66
$175,263,531	Assets per balance sheet of Debtor as of 8/31/39, as stated in Commission's supplemental report dated 11/21/39 authorizing extension of trustees' certificates	67

All of these figures were before the Commission before it made its modifying report and order of June 21, 1939 in this proceeding, except those in connection with the report of the Commission dated November 21, 1939, authorizing an extension of maturity of the trustees' certificates theretofore issued (Stip. Par. 67, R. 1061).

The final valuations of the properties of the Debtor and of its subsidiaries under 19(a), with the addition of the net costs of additions and retirements necessary to bring

them down to the later dates under consideration (Stip. Pars. 57-59, R. 1058-9), and the showing of total assets on the books of the Debtor's trustees (Stip. Par. 63, R. 1060) are referred to without disapproval, question or criticism in the report of October 10, 1938 (R. 224).

The report of October 10, 1938 (R. 224) refers to the Commission's valuation under Section 19(a) of the Interstate Commerce Act, as a report of "the value for rate-making purposes." There is no warrant in the law for any attempt to so limit the purposes for which such a valuation is to be used. The Interstate Commerce Act, of which Section 19(a) is a part, gives the Commission various powers other than that of rate-making, and the value fixed under Section 19(a) is applicable to the exercise of some of these. "It is apparent, therefore, that the establishment of a base for the fixing of rates is merely one of a number of objectives to be attained through this valuation. Nowhere in the Act is there anything that either expressly or by inference can be distorted into the limitation of this valuation for rate-making purposes. The statute, on the contrary, provides that it shall be a valuation of all the property of the railway company." (*New York N. H. etc. R. Co. v. I. C. C.*, 55 Fed. (2d) 1028, 1035). One of the Commission's powers is to control the issuance of securities by railroads. (Section 20(a)). With this in mind, the Court said in

Delaware & Hudson Co. v. U. S., 295 Fed. 558, 560:

> "The evident object of the statute (Sec. 19(a)) is to ascertain for purposes of rate-making and money borrowing the reasonable and probable going value of that property which is devoted to serving the public as a common carrier."

Some of the findings of value of the property of the Debtor, as set forth in the Stip., were made by the Commission in proceedings for the authorization of securities, as when the Commission, in authorizing the issuance of refunding bonds, found the capital assets of the Debtor, as of December 31, 1931, and as of May 31, 1932, respectively, to be something over $147,000,000 and something over $148,000,000 (Stip. Pars. 64 and 65, R. 1060-61).

The same is true of the reports of November 10, 1938 and November 21, 1939, authorizing the issuing and the extension of Trustees' certificates (Stip. Pars. 66, 67, R. 1061). The first of these reports states assets in excess of $174,000,000 and the second in excess of $175,000,000.

Comparing all of these different figures we see that the lowest valuation of the properties of the Debtor is the one referred to in its report of October 10, 1938, which shows a total valuation, as of December 31, 1935, of $139,600,455. The book value of the assets of the Debtor is $171,096,992.80 as of November 30, 1936 (Stip. Par. 62, R. 1060).

Disregarding all but the least of these figures, i. e., $139,600,455, there is a difference between the value of the properties of the Debtor and the total secured claims (i. e., $87,888,660, which alone are given recognition in the Commission Plan) of over $50,000,000. On the same basis there is an excess of asset value of more than $40,000,000 over the total amount of claims secured and unsecured.

(b) Under Section 77 valuation of railroad property is to be based—in addition to "other relevant facts"—on "earning power", not on "prospective" or "probable future" earnings.

In the event that this Court shall deem it proper (even though, perhaps, not necessary to the decision of the appeals before it) to interpret the valuation provision of subsection (e), we submit the following suggestions, based on the language of the legislative enactment.

The ultimate point of inquiry (apart from "other relevant facts") is the *earning power*, i. e., what, as an enterprise dedicated to a public service, and subject to regulation in the public interest, it is capable of earning. As a guide or help in estimating that capacity, regard may be had to past earnings and to earnings which may reasonably be anticipated in the future, but neither of these factors expresses the final test, or measure, or basis of value. Each is merely an indication, which, with others, furnishes an aid to an appraisal or estimate of what the property is capable of earning. That past or present earnings, by themselves, do not afford a sufficient foundation for estimating what the property might, or could, earn in the future, is clearly set forth in the passage already quoted (ante, p. 43) from the opinion in the *Consolidated Rock Products* case.

Nor are the "prospective" or "probable" earnings the equivalent of "earning power". The words "past, present and prospective", in subsection (e), do not refer to actual earnings or an estimate of future earnings. They are used as a qualification of the term "earning power of the property". An estimate of prospective or probable earnings relates to a future period, of greater or shorter dura-

tion, and is necessarily based upon conditions existing at the time of the inquiry or reasonably foreseeable. What a property can earn—what it is capable of earning—is not the same as what, at any given time, it is likely to earn over a future period.

Section 77 itself differentiates between "probable earnings" and "earning power" and applies the terms to different purposes. Under subsection (b)(4) the plan is to provide for fixed charges in such an amount that "there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof". When we come to the valuation provision of subsection (e) the statute departs from the measure of "probable earnings" and makes the basis "earning power" (with other relevant facts). This change of expression would, presumably, not have been adopted if the legislative body regarded the two phrases as synonymous. The Commission seems, however, to have viewed "probable earnings" not only as a limitation on fixed charges, as prescribed in subsection (b)(4), but also as a measure of valuation of the property, or of total capitalization. In its report of October 21, 1938 (R. 244), the Commission states that in fixing the capital structure of the reorganized company "consideration (must be) given to the investment in its property only to the extent that such investment is justified by the probable earnings reasonably foreseeable for the future".

It may be difficult to estimate the earning capacity of a railroad property. But the history of the Western Pacific property, before and after the formulation of the Commission Plan, shows that that capacity is much greater

than was envisaged by the Commission when it made its report. In some predepression years the Debtor's properties earned more than enough to meet all fixed charges under the old capitalization. In the past two and one-half years, it has again demonstrated its capacity to earn substantial amounts beyond the service of its pre-existing fixed charges, and the earnings are advancing steadily and at a rapid rate. The difficulty of estimating earning capacity affords no reason why the Commission should not be required to perform the task to the best of its ability. As this Court said in *Consolidated Rock Products* case (312 U. S. at p. 516): "an estimate as distinguished from mathematical certitude is all that can be made". So much, however, is, we submit, required by the language of subsection (e).

The distinction between "earning power" and "prospective or probable earnings" is not without a sound basis of reason. We are dealing with a statutory scheme for enforcing a reorganization which may result (as, in this case, it will if it becomes effective) in the extinction of interests which were of great value when acquired, and which, as their owners claim, still have substantial value presently, and greater prospective value. It is only fair and just that these interests should not be irrevocably destroyed, unless it appears that the property has not the capacity to earn enough—after full provision for all senior claims—to show a value which will permit a proper provision for the junior claimants.

VI.

EARNINGS SINCE COMMISSION'S REPORT WAS CERTIFIED.

The original Report and Order of the Commission approving a Plan of Reorganization was dated October 21, 1938 (R. 194-299). The modifying Report, under which the Plan here in question was certified to the District Court, was dated July 29, 1939 (R. 300-400). In its modifying and final Report the Commission did not review or reconsider any earnings later in ti... than those before the Commission when it made its original Report of October, 1938.

The monthly income statements showing the combined results of the operation of the properties of the Debtor and its subsidiaries from December, 1938, (shortly after the date of the original Report) up to the argument of the appeals in the Circuit Court of Appeals, were, pursuant to an Order of the District Court, dated April 7, 1942,[32] filed with the Clerks of the District Court and of the Circuit Court of Appeals, and made a part of the record on said appeals. Similar statements for months subsequent to September, 1941, have, by stipulation of the parties, dated July 18, 1942, and filed in this Court, been made a part of the record here. At the time of the preparation of this brief, the statements so filed and transmitted to this Court run to and include the month of June, 1942.

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[32] (R. 2627)—The order recites that it is made pursuant to a stipulation of the parties.

For statements covering period from December, 1938 to May, 1941, see R. 2633-36; from June, 1941 to September, 1941, see R. 2649-57.

In the *Chicago, Milwaukee* case, later earnings were not incorporated in the record on appeal (124 Fed. (2d) 754, 763).

In view of the stipulations referred to, we assume that no party to these appeals will question our right to refer to the earnings record of the Debtor during the period that has elapsed since the Commission's Report. Regardless of the want of any such objection the Court may, however, have some doubt of the propriety of taking into account facts which have developed since the Commission acted, and indeed since the District Court made the order of approval which is the subject of the present appeals.

The holdings of this Court in analogous cases establish, we submit, the propriety, if not the necessity, of a consideration of the state of facts existing when the Court of final appeal renders its decision, even though the actions of the trial Court and of the Commission might be held to have been sustainable on the facts appearing when those earlier actions were taken.

In

Atchison etc. R. Co. v. U. S., 284 U. S. 248,

this Court held, in a suit by carriers to restrain the enforcement of an order of the Interstate Commerce Commission prescribing maximum rates for the transportation of grain, that the petitioner's constitutional rights had been invaded by the action of the Commission in refusing a rehearing sought on the ground that in the three or four years elapsing after the closing of the record before the Commission there had been material and important changes in the operating, traffic and transportation conditions which affected adversely the revenues of the carrier, and that "regardless of the question of the validity and propriety of the order when made, it would no longer be valid and proper in the light of the existing

circumstances."[33] In that case the changes were those incident to the depression beginning after the Commission had concluded its investigation of the facts. The Court took judicial notice of such changes.

Similarly in

Central Ky. N. G. Co. v. Railroad Commission, 290 U. S. 264,

a case involving the validity of a rate prescribed by a State Commission for the sale of natural gas, this Court held that it would take judicial notice of economic changes taking place while the case was pending before the Commission and the Court, and would frame its decree accordingly.[34]

In the instant case, as in the *Atchison* and *Central Kentucky* cases just referred to, the action assailed would, if sustained, operate in the future. In those cases the public utility affected would have been held to a rate which would be confiscatory under conditions existing at the time of the review by the Appellate Court, although not necessarily so at the time of the order of the Commission. Likewise here, the confirmation of the Plan of Reorganization would operate for all time in the future, and, in the case of this respondent, would absolutely destroy its investment and claim without any possibility of recovery or recoupment, no matter how much conditions had changed since the Commission made its report or might change hereafter.[35] Probably the Court would be warranted in

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[33]284 U. S. 256.

[34]See also *Southern Pacific Company v. Bogert*, 250 U. S. 483.

[35]A similar principle has been applied by this Court in its holdings that an injunction properly granted under the law then in force should be set aside on appeal where there has been an intervening change in the law (*American Steel Foundries v. Tri-*

taking judicial notice of the sharp increase in railroad earnings that has taken place during the past two or three years. But it is not necessary here to rely on judicial notice alone, as the actual figures of this Debtor's recent increase of earnings are, under Stipulation and Order, before the Court.

The earnings record of the Debtor for the period since 1938 throws a strong light on the fairness of the Plan, formulated, as it was, when the results of the Debtor's operations for years after 1938 could not be known.[36]

The following is a table showing:

ADJUSTED[37] CONSOLIDATED EARNINGS AVAILABLE FOR INTEREST

For the years 1922 to 1938, inclusive (R. 1065-1066 and Supplemental Record)

1922	$2,204,890
1923	4,412,234
1924	3,241,823
1925	4,557,798
1926	4,868,390
1927	3,470,861
1928	4,376,972

City Central Trades Council, 257 U. S. 184, 201; *Texas Company v. Brown*, 258 U. S. 466; see, also, *Duplex Printing Press Co. v. Deering*, 254 U. S. 443, 464; *Tulare Irr. Dist. v. Lindsay-Strathmore Irr. Dist.*, 3 Cal. (2d) 489, 526-8).

[36] In the figures which follow we deal with the earnings as if the results for the entire year 1938 had been before the Commission, although the original Report was dated October 10, 1938.

[37] In this table the reported earnings are adjusted to take into account (a) rehabilitation expenditures 1927-1931 and 1934-1938; (b) amortization of discount on first mortgage bonds of Debtor; and (c) deductions and credits 1931-34 made by Commission to accord with its accounting rules (Stip., par. 76, R. 1065).

1929	3,718,436	
1930	2,381,529	
1931	220,494	(Deficit)
1932	283,912	
1933	474,365	
1934	1,396,353	
1935	1,377,026	
1936	1,901,423	
1937	1,077,407	
1938	225,431	

The later income statements showing results of the operations of the Debtor's properties for the full years 1939, 1940, 1941 and for the first six months of 1942 disclose the following earnings available for interest:

Year	As Reported	Adjusted
1939	$1,384,515	$1,519,916
1940	2,513,091	2,648,492
1941	4,551,738	4,687,140
1942 (1st 6 months)	4,080,090	4,147,791

The statements for the three and one-half years following 1938 show an enormous increase in the Debtor's earnings since the adoption of the Plan. This increase is no doubt due to a variety of causes. Since the adoption of the Plan business and industry have largely emerged from a period of depression to one of recovery, and, in the case of this Debtor, the efficient condition of its property, and the availability of the Northern California Extension have unquestionably contributed to its increased earnings. The stimulus to production and transportation incident to the war effort since December, 1941 and the lesser impulse created by preparations for defense during earlier months

have certainly played a large part in increasing the traffic and the earnings of railroad companies generally, among them the Western Pacific. We do not undertake to apportion the improved position of the Debtor among these various causes, nor do we pretend to be able to estimate the length of time during which the pressures of war, or of the post-war period to follow, will continue to exert a beneficial effect upon the earnings and earning prospects of the Debtor. At the least, it may be said with assurance that the Commission formulated its Plan at a time when the Debtor's properties had gone through a prolonged period of economic depression, and at a time when its earnings were almost at their lowest point. We believe there can be no doubt that if the Commission were today called upon to formulate a plan, in the light of the history of the three and one-half years that have elapsed since January 1, 1939, the ensuing plan would be very different from the one which was certified to the District Court.

In other words, the "other relevant facts" now appearing go far to demonstrate that the Debtor's property has an earning capacity greatly in excess of any estimate of such earning capacity which the Commission would have had to make (though in fact no estimate was made by it) in order to justify the capitalization provided by the Plan.

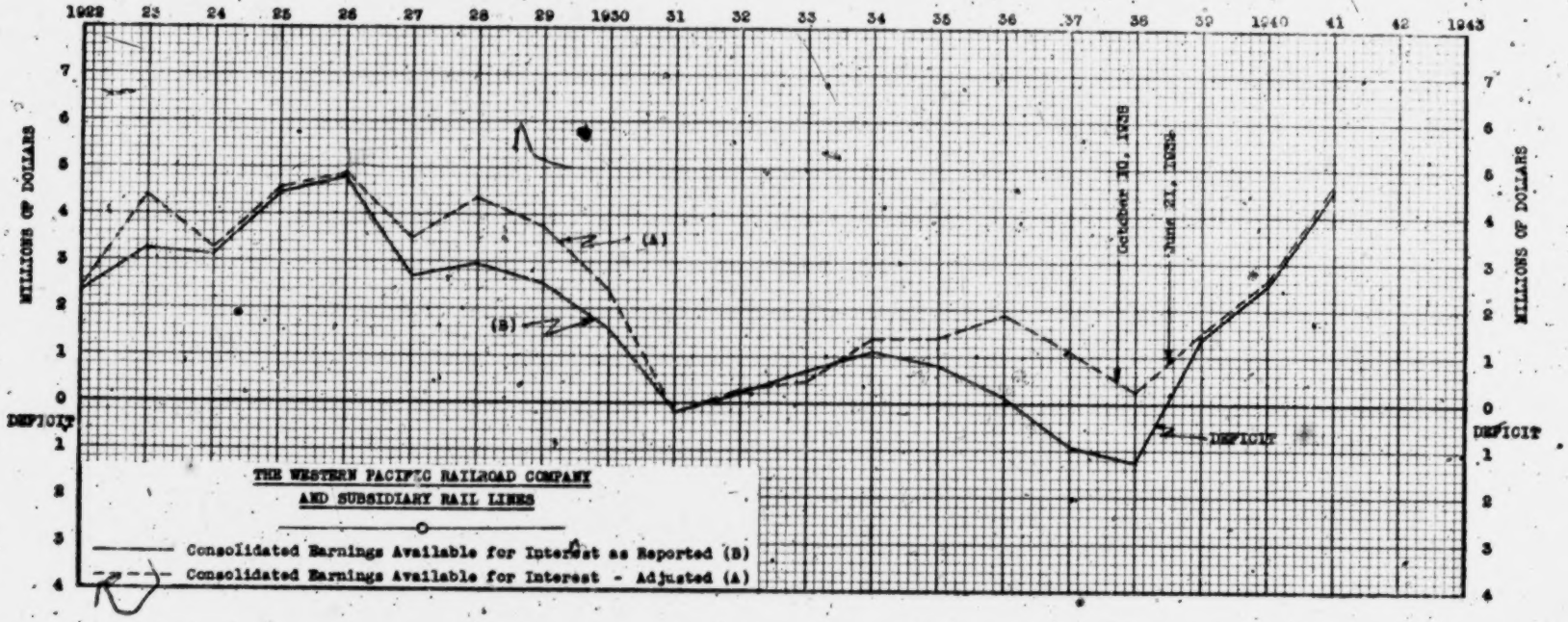
Summarizing the earnings figures tabulated above, we find out that in the year 1939 the adjusted earnings of the system available for interest increased from $229,097.45 (the figure for 1938) to $1,519,915.81, an increase of 563.04%; that in the year 1940 there was a further increase, bringing the adjusted earnings from $1,519,916 to $2,648,492, an increase of 74.25% over the 1939 figure.

The adjusted earnings for 1941 were $4,687,140, an increase of 76.97% over 1940.

(The figures of earnings available for interest for the first six months of 1942 do not lend themselves to an entirely trustworthy comparison, for the reason that probable federal income tax liability for the year 1942 cannot be determined with accuracy at this time. It may, however, be pointed out, as indicating the continuing upward curve of earnings of the Western Pacific system, that for this six months' period total railway operating revenues amounted to $16,235,602 as against $10,111,000.28 in the corresponding period of 1941,—an increase of 60.57%.)

To further illustrate the conditions which we have described we insert a chart showing graphically the earnings of the Western Pacific system from the year 1922 to the year 1941. The solid line on the curve indicates reported consolidated earnings available for interest as filed with the Interstate Commerce Commission. The broken line represents adjusted earnings available for interest.

The graph also indicates the points on the curve at which the Commission's original Report of October 10, 1938 and its final modifying report of June 21, 1939 were made. A glance at the chart is sufficient to show that the Commission Plan was formulated and announced at a time when the earning picture of the Debtor was extraordinarily unfavorable. The unadjusted earnings had reached the lowest point ever attained during the entire period depicted; while the adjusted earnings were at or near a point of decline exceeded only in the depths of the depression and then briefly. The subsequent upswing, which has already brought the earnings virtually up to the


1922
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1943
MILLIONS OF DOLLARS
DEFICIT
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1
0
1
2
3
4
(A)
(B)
October 31, 1935
June 21, 1938
DEFICIT
THE WESTERN PACIFIC RAILROAD COMPANY
AND SUBSIDIARY RAIL LINES
Consolidated Earnings Available for Interest as Reported (B)
Consolidated Earnings Available for Interest - Adjusted (A)

highest point in the prosperous predepression level, had not yet manifested itself.

It is submitted that both the Commission and the Court failed to take into account the "other relevant facts" mentioned in subsection (e) of Section 77, or the "circumstances which indicate whether or not the (earnings) record is a reliable criterion of future performance", spoken of in the *Consolidated Rock Products* case. Because of their failure to do so the Commission and the District Court concluded (without supporting the conclusion by explicit findings) that the probable future earnings (or, in the words of subsection (e), the "earning power" of the property) would not warrant the inclusion of this respondent.

CONCLUSION.

It is respectfully urged that the decree of the Circuit Court of Appeals, reversing the order of the District Court approving the Commission Plan, should be affirmed, and that this Court give such instructions as it may deem proper for the guidance of the District Court and the Commission in the further steps to be taken in the proceeding.

Dated, San Francisco, California,
October 1, 1942.

Respectfully submitted,
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